STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

North Shore Gas Company	:	
	:	**Docket No. 12-0511**
Proposed general increase in rates for gas distribution service	:	
	:	**(cons.)**
The Peoples Gas Light and Coke Company	:	
	:	**Docket No. 12-0512**
Proposed general increase in rates for gas distribution service	:	

REPLY BRIEF ON EXCEPTIONS OF THE
STAFF OF THE ILLINOIS COMMERCE COMMISSION

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May 16, 2013

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Now comes the Staff of the Illinois Commerce Commission ("Staff"), by and through its undersigned attorneys, and pursuant to Section 200.830 of the Rules of Practice of the Illinois Commerce Commission (“Commission”), 83 Ill. Adm. Code Section 200.830, respectfully submits this Reply Brief on Exceptions to the briefs on exceptions (“BOEs”) filed by North Shore Gas Company (“North Shore” or the “Company”) and The Peoples Gas Light And Coke Company (“Peoples Gas” or the “Company”) (collectively referred to as the “Companies” or “Utilities”) (“the Companies’ BOE” or “Companies BOE”)[1]; the People Of The State Of Illinois (“AG BOE”); the Citizens Utility Board And the City Of Chicago (“CUB-City BOE”); and Interstate Gas Supply of Illinois (“IGS BOE”) which were filed on or before May 9, 2013 in response to

[1] Staff’s citations to the Companies’ BOE refer to the brief filed on May 9th and not the revised brief filed on May 14, 2013 by the Companies.

the Administrative Law Judges' Proposed Order ("Proposed Order," "PO," or "ALJPO") issued April 26, 2013.[2]

[2] The outline used by Staff in this Reply Brief on Exceptions follows the agreed outline which Staff also used for its Initial Brief Reply Brief and Brief on Exceptions. That outline differs in some respects from the PO's outline. The outline for the Staff brief on exceptions also included "Technical Correction" and "Conclusion" sections following Section X.

C. Potentially Contested Issues (All Subjects Relate to NS and PGL Unless Otherwise Noted)

1. Year End Rate Base or Average Rate Base

Of the parties filing BOEs on Year End Rate Base or Average Rate Base, only the Companies disagree with the ALJPO's appropriate and logical conclusions. While the ALJPO presents overwhelming support for its conclusions, Staff agrees that the proposed modifications in CUB-City's Exception No. 1 (CUB-City BOE, pp. 7-8) would provide further clarity to the ALJPO.

The Companies' BOE provides no new insight into this issue, and therefore, their exceptions should be rejected. However, the Companies make some misleading assertions which must be addressed.

Impact

The Companies' Exception No. 1 notes the "huge impact" that the ALJPO's conclusion has on rate base (NS-PGL BOE, p. 13). The Companies have this statement exactly backwards. The ALJPO makes a rational conclusion that is consistent with prior Commission decisions and correctly measures the rate base for the test year. The only valid point that the Companies raise is that the correctly measured rate base does not result in the revenue that the Companies desire. Therefore, the Companies would be more accurate in stating that using the year-end rate base, as the Companies propose, would have a huge impact on rate base causing Peoples Gas' and North Shore's annual revenues (cost recovery) to be **overstated** by $9,854,000 and $658,000, respectively.

Test Year

In Staff's view, the Companies' use of the year-end rate base is really the approximate average of rate base during the last six months of the test year and the first six months after the test year. Unfortunately, rate base amounts during the six-month period after the end of the test year are not in the record.

The Companies could have selected a future test year with an ending date as far out as July 31, 2014, which would have included these rate base amounts; however, the Companies chose to not use that test year. Whether rate base as of December 31, 2013 might be an approximation of the average rate base for a test year ending July 31, 2014 is unknown since that information is not in the record. (Staff IB, p. 14)

The ending date of the test year was the Companies' choice. The Commission should not be asked to deviate from the established practice and adopt an improperly measured rate base. (Staff IB, p. 14)

The Companies complain that the ALJPO does not allow the opportunity for full cost recovery. (NS-PGL BOE, p. 13) However, the problem is not with the ALJPO which correctly measures the rate base for the test year filed by the Companies. The problem is with the Companies' desire to recover investments made after their chosen test year. The Companies are not prevented from recovering the costs of projected investments occurring after the future test year, as the Companies are free to file new rate cases which could include these additional investments. (Staff IB, p. 13)

Matching

The Companies wish to use matching of costs and rates to justify the use of a year-end rate base. (NS-PGL BOE, p. 15) The Companies, however, do not wish to use the costs of the test year. This is particularly evident in the Companies' last minute offer to use the average rate base of the last six months of the test year. This alternative would result in the matching of rates to the average cost of some of the test year. The Companies' approach to matching would only be justified if rates are matched to post test year costs; which are not in the record. Thus, the ALJPO correctly matches rates to costs by using the average rate base of the test year.

The Companies make reference to Staff witness Kahle's cross-examination as testifying that revenues should equal the rate base investment of the test year plus the expenses of the test year. (NS-PGL BOE, p. 15) However, later in Mr. Kahle's testimony he clarified that revenues are the company's net income (rate of return on the rate base) plus operating expenses. (*Tr*. February 4, 2013, p. 164) The Companies, however, make no argument addressing this clarification nor do they demonstrate how this statement supports their position. Staff's revenue requirements are based on net income (rate of return on average rate base) plus operating expenses.

The Companies also make reference to Staff witness Ostrander's direct testimony (Staff Ex. 3.0) in an attempt to redefine proper matching. The Companies assert that the ALJPO is inconsistent. The Companies argue that while the ALJPO rejected their position that an end of year method and their alternative proposal better match cost of service during the period rates will be in effect, the ALJPO's recommendation on non-union wages is based on Staff witness Ostrander's theory that rates should be set in a manner that reflects costs during the period rates will be in effect. (NS-PGL BOE, p. 16) A closer look at Staff Ex. 3.0, Schedule 3.03 reveals that Mr. Ostrander made adjustments to non-union wages for 2013, the test year, and not to a period beyond the test year.

Alternate Proposal

The Companies attempt to argue that the lack of argument against their alternate proposal, which was *first introduced in the Companies' surrebuttal testimony*, should be considered supportive of their position despite the fact that neither Staff, the AG, nor CUB-City had an opportunity to present arguments responsive to their proposal. (NS-PGL BOE, p. 18) The ALJPO correctly dismisses this belated proposal since Staff, the AG, and CUB-City did not have the opportunity to seriously consider or investigate this alternative proposal due to time constraints. (Staff IB, pp. 15-16)

Furthermore, while calculation of the alternate proposal is straight forward, the concept of using the average of half of a test year to establish rate base is unique. Staff is not aware of this method of measuring rate base coming before the Commission in a prior rate case. Thus, the ALJPO is correct in not considering this alternative without it first having been properly vetted through the filing of direct and rebuttal testimony in a rate case proceeding.

Forward Looking

Finally, the Companies argue against the concept that the use of a future test year, with the average rate base, is sufficiently "forward looking" to relieve concern over under-recovery of costs. (NS-PGL BOE, p. 19) While it is unclear to what the Companies' vague reference to "shown above" refers, it is clear that the supposed under-recovery is the Companies' invention of comparing revenue derived from post test year cost recovery to revenues derived from test year cost recovery. Staff has addressed the recovery of costs of projected investments occurring after the future test year as the Companies are free to file new rate cases which could include these additional investments. (Staff IB, p. 13) The Companies' proposal would have rates based upon a year-end rate base that would go into effect six months before the plant expenditures were even incurred. The ALJPO correctly takes into account that rates are set to go into effect around July 2013, six months prior to the end of the future test year. Thus, there is no shortfall and no regulatory lag to be incurred by the Companies as rates will go into effect in the middle of the test year.

Technical Exceptions

Staff Technical Exception No. 1

Staff noted a technical exception that, on page 15 of ALJPO Appendix A, the balances for North Shore's ADIT (Column E on lines 1, 2, and 3) are shown as positive amounts when they are actually negative. (Staff BOE, p. 4) The AG has proposed this same exception. (AG BOE, p. 57 (Mechanical Errors, 2nd par) The Commission should adopt the corrections.

Staff Technical Exception No. 2

Staff noted a technical exception that the disallowance of the Non-AMRP Gas additions for Peoples Gas in the revenue requirement schedules needs to be corrected to reflect that 100% (instead of 150%) of the Non-AMRP additions are being removed from rate base. (Staff BOE, p. 5) The Companies have proposed this same exception. (NS-PGL BOE, pp. 22-23, Technical Exception No. 2) The Commission should adopt the correction.

2. Plant

a. Forecasted Test Year Capital Additions – Utility Plant in Service (NS)

Staff agreed with the ALJPO's analysis and conclusions on page 40 under the Forecasted Test Year Capital Additions – Utility Plant in Service (NS) section and did not take exception to basing the adjustment on a five-year average of budget to actual variances. (Staff BOE, p. 6)

North Shore states that its experience with public improvement projects proves that the ALJPO's adjustment is improper. (NS-PGL BOE, p. 20) How the Company believes that it helps its cause by pointing out that its experience supports the ALJPO's adjustment to reduce rate base, is unfathomable. It is the Company's inability to accurately forecast and budget for public improvement projects that calls for this adjustment. The Company's exception does nothing but recite the deficiency that gives rise to the adjustment and should be discarded.

b. Accelerated Main Replacement Program Projects (PGL)

i. Section 8-102 Investigation of AMRP

ii. AMRP Adjustment

c. Construction Work in Progress (PGL)

d. Non-Union Wages (see also Section V.C.2)

e. Capital Costs for Non-AMRP Gas Services

Peoples Gas disputes the PO's conclusion that the parties were prejudiced when it made its eleventh hour adjustment of the amount for Non-AMRP Gas Services in its surrebuttal filing. (NS-PGL BOE, p. 21) Peoples Gas states the parties were not unfairly precluded from preparing any reasonable amount of discovery because the correction of the amount occurred in surrebuttal (*Id.,* p. 22) and Staff or other parties could have issued discovery or conducted cross examination of the Companies' witness. To support this fallacy, Peoples Gas used the "example" of Mr. Seagle's review of the Calumet System Upgrade, Mr. Kahle's review of Mr. Hengtgen's testimony, and Mr. Kahle's filing of Supplemental Rebuttal Testimony as examples to prove that parties were not prejudiced by this late filing. (*Id*., pp. 21 - 22). Staff disputes Peoples Gas arguments because they are not based in fact.

Peoples Gas claims its "example" of Mr. Seagle's review of the Calumet System Upgrade shows Staff's ability to perform robust discovery after the filing of Peoples Gas' surrebuttal testimony. Peoples Gas' "example" noted that Staff witness Seagle reviewed Utilities witness Mr. Hoops' surrebuttal testimony concerning the Calumet System Upgrade and agreed that the project should be included in rate base. (*Id.,* p. 22) However, Peoples Gas overlooks or chose to ignore the record regarding Staff's review of the Calumet System Upgrade.

Peoples Gas fails to consider that Staff had the opportunity to and did review the Calumet System Upgrade from the very beginning of the instant proceeding from the documentation submitted with Peoples Gas' initial 285 filling, in particular PGL's Schedule F-4, p. 1, Line 2, column D (Staff Ex. 6.0, p. 25) Further, Staff disputed the Calumet System Upgrade issue in both its direct and rebuttal testimony, and the issue was subject to extensive discovery by Staff. (*Id.*, pp. 26-28, Staff Ex. 16.0, pp. 10-13) Peoples Gas also provided rebuttal and surrebuttal testimony about the project. Peoples Gas' surrebuttal testimony provided an updated business case for the Calumet System Upgrade (NS-PGL Ex. 44.3) and contained sufficient information for Staff to withdraw its adjustment (NS-PGL Cross Ex. 13).

In other words, Staff's review of the Calumet System Upgrade did not start after Peoples Gas' surrebuttal filing. Staff spent a considerable amount of time reviewing the Calumet System Upgrade throughout the proceeding and identified for Peoples Gas the various shortcomings in its data regarding the project. Peoples Gas' surrebuttal testimony did provide Staff with the information necessary to include this project into Peoples Gas' requested rates and it did not require Staff to conduct any further investigation after the surrebuttal filing. For Peoples Gas to argue that the Calumet System Upgrade is similar to the 11th hour adjustment for Non-AMRP Gas Services is ludicrous.

Likewise, Mr. Kahle's review of Mr. Hengtgen's alternative proposal for pass-through taxes in the lead-lag study was on a topic that Mr. Kahle had issued discovery on and was familiar with. Mr. Hengtgen's alternative proposal had largely been discussed in Mr. Hengtgen's rebuttal testimony. Finally, Mr. Kahle's Supplemental

Rebuttal Testimony provided an adjustment updated with 2012 data as Mr. Kahle had discussed in his direct testimony. Further, Mr. Kahle's Supplemental Rebuttal Testimony was updated with data provided by North Shore for the purpose stated. Again these circumstances are quite different from the adjustments for Non-AMRP Gas Services.

The Company also attempts to justify this late adjustment for Non-AMRP Gas services by stating: "no party objected to the Utilities' surrebuttal reflecting 2013 bonus depreciation, reducing rate base, based on the passage of the American Taxpayer Relief Act of 2012 enacted in January 2013." (NS-PGL BOE, p. 22) This is again is an example of a topic which was not a surprise to the parties. All parties expected this filing. Furthermore, bonus depreciation itself is a familiar issue with the parties which they could assess without extensive research or discovery which was not possible with the last minute adjustment for Non-AMRP Gas services.

Finally, if the Commission were to agree with Peoples Gas' request, that would only encourage more last minute "discovery" of unknown errors by Peoples Gas and other utilities and cause great harm to the principles the Commission uses to maintain fairness in its proceedings. Therefore, Staff recommends that the Commission reject Peoples Gas' arguments to alter the PO's conclusion regarding the request for inclusion in rate base of Capital Costs for Non-AMRP Gas Services.

3. Cash Working Capital

a. Pass-Through Taxes

The Companies' Technical Exception No. 3 points out an error in the Cash Working Capital ("CWC") computation. (NS-PGL BOE, p. 23) Staff is in agreement that the Companies' revenue lag should also be applied to ICC Gas Revenue Tax as the ALJPO correctly states, and that the corrections to the Appendixes that the Companies recommend are appropriate. (*Id.*)

b. Pension/OPEB

The Companies' Exception No. 4 relating to lead days for Pension/OPEB[3] expenses should be rejected. (NS-PGL BOE, p. 24)

CWC is the amount of funds required from investors to finance the day-to-day operations of the Companies. The Companies' operating expenses are reflected on the revenue requirement. (Staff IB, p. 31) The Companies' argument that the Pension/OPEB operating expense reflected in their revenue requirement can be ignored in the CWC calculation because the expense is included in rate base, is baffling. It is not clear how this expense could be "duplicative because pension and OPEB as balance sheet items are already (or should be) included in rate base". (NS-PGL BOE, p. 25) Ratepayers provide recovery of the cost of the pension plan through pension expense which is reflected in the revenue requirement and, in turn, is recovered from ratepayers through rates. (Staff IB, p. 36)

[3] Other Post-Employment Benefits.

While it is not clear how this expense could be included in rate base (NS-PGL BOE, p. 25), were that true, the Companies would not need to recover the cost of financing the expense through CWC. In that case, an amount equal to pension and OPEB expenses in the CWC calculation should be separated from revenue and be given zero days for revenue lag. (Staff RB, pp. 24-25)

Interestingly, the Companies make an argument that there is no relation between intercompany billing payments and pension and OPEB expenses. (NS-PGL BOE, p. 25) The Companies make this argument in spite of their admission that, in the Companies' prior CWC calculations, pension and OPEB expenses were included in intercompany billing. (Staff RB, p. 24) The Companies do, however, manage to find some relationship that makes using intercompany billing payments lead days preferable to the higher other operations and maintenance expense lead days proposed by the AG. (NS-PGL BOE, p. 25)

The Companies point out that their proposal is the same that Mr. Kahle made in a different rate case for a different utility. (NS-PGL BOE, p. 25) The Companies, however, ignore Mr. Kahle's explanation of his rationale for a treatment different in this proceeding. The Company also fails to note that this issue was not contested in the other proceeding. (Staff RB, p. 25)

c. All Other

The AG takes exception to the pass-through taxes lead days used in the ALJPO. (AG BOE, p. 11) The ALJPO adopted the Companies' alternative approach offered in their surrebuttal testimony that used zero lag days for pass-through taxes, except for

ICC Gas Revenue Tax. The Companies' alternative approach used the actual number of days that the Companies held pass-through taxes for lead days. Staff accepted this alternative approach on cross examination. (*Tr*., February 4, 2013, pp. 151-152; Staff IB, pp. 30-32)

Using zero days for the lag days for pass-through taxes reflects that pass-through taxes are not revenue. Using the actual number of days that the Companies hold pass-through taxes for lead days reflects the number of days that the Companies have use of ratepayer supplied funds as pass-through taxes. The AG's exception should be rejected.

4. Retirement Benefits, Net

The ALJs appropriately recognized that the Companies have offered no new credible arguments which would cause the Commission to reconsider its prior decisions in the Companies' last three rate cases concerning the retirement benefits, net issue. Both the Companies' main position (return on a pension asset) and their two alternative positions (return on certain North Shore pension contributions and exclude the OPEB liabilities from rate bases) (NS-PGL BOE, pp. 27-29) have been rejected by the Commission on one or more occasions. Yet the Companies insist on taking exception to the PO on the retirement benefits, net issue.

The Companies take exception to the PO arguing that they have presented new facts or evidence in this evidentiary record to reverse the Commission's decisions in the Companies' 2007, 2009, and 2011 rate cases. (*Id*., pp. 25-30) As stated above, there are no new credible arguments made by the Companies in this case. The arguments have either been previously rejected by the Commission or should be rejected in this case for the reasons set forth below. If the Commission believes that the PO should respond specifically to the Companies' five grounds which the Companies allege are new or different circumstances to the evidentiary record in this case (*Id*., p. 28), then Staff provides some language for the Commission to consider modifying the PO. The language rejects the five grounds set forth in the Companies' BOE and rejects the alternative arguments made by the Companies in their BOE. (*Id.*, pp. 27-30)

<u>Alleged Ground No. 1</u>

The Companies' first ground for the Commission to reconsider its decision in its prior orders regarding the issue of retirement benefits, net is that it is wrong as a matter of law for the Commission to consider that when customers pay their bills they have paid for the utility's assets. (*Id*., p. 27) The Companies cite to an eighty-seven year old case, *Bd of Pub. Utility Commissioners, et al. v. New York Tel Co*., 271 U.S. 23 (1926) the same case they cited to in their 2011 rate case. While the Companies suggest this is a change in circumstance, i.e., something new for the Commission to consider, the Commission already considered this argument before in the 2011 case and did not find it persuasive and should do so again here.

As Staff pointed out in its reply brief, the case cited by the Companies, *Bd. of Pub. Utility Commissioners,* is essentially a retroactive ratemaking case. Staff is aware of the issue of retroactive ratemaking as well as Illinois case law on the issue. (*See*, *Mandel Brothers, Inc. v. Illinois Commerce Comm'n*, 2 Ill. 2d 205, 210 (1954) and a number of subsequent decisions (*Citizens Utilities Co. v. Illinois Commerce Comm'n*, 124 Ill. 2d 195, 206-211 (1988)). The Companies have not argued that Staff's position is retroactive ratemaking, which it is not; therefore the eighty-seven year old case is not relevant to the issue in this case. The Companies are seeking to collect monies from ratepayers and then charge those ratepayers with a return on investment of those monies. What is relevant, which the Companies have not disputed, is that under Illinois law for ratemaking purposes a public utility may not receive a return on investment from ratepayers for ratepayer-supplied funds. (*City of Alton v. Illinois Commerce Comm'n,* 19 Ill. 2d 76, 85-6 and 91 (1960); *DuPage Utility Co. v. Illinois Commerce Comm'n*, 47 Ill. 2d 550, 554 and 558 (1971); and *Central Illinois Light Co. v. Illinois Commerce Comm'n*, 252 Ill. App. 3d 577, 583-3 (3rd Dist., 1993). *See also Business and Professional People for the Public Interest v. Illinois Commerce Comm'n ("BPI II"),* 146 Ill. 2d 175, 258 (1991)) Staff Witness Pearce testified that the Companies failed to show that the "pension asset" was provided by discrete shareholder contributions and, as a result, "[t]he pension asset should not be included in rate base because it was not created with funds supplied by shareholders." (Staff Ex. 4.0, p. 4)

The Commission has consistently rejected the attempts of other utilities to receive a return on ratepayer-supplied funds and should do so again here. (*Central Illinois Light Co. d/b/a AmerenCILCO, et al.,* Order, Docket Nos. 06-0070, 06-0071, and 06-0072, (cons.), November 21, 2006, pp. 27-28; *Northern Illinois Gas Company d/b/a Nicor Gas Company*, Order, Docket No. 04-0779, September 20, 2005, pp. 22-23; *Northern Illinois Gas Co. ("Nigas"),* Order, Docket No. 95-0219, April 3, 1996, pp. 9-10, 1996 Ill. PUC LEXIS 204, *19-*23, *affd. sub nom*. *Nigas, et al. v. Illinois Commerce Comm'n,* Order of June 23, 1997, Appeal Nos. 3-96-0473, etc. (cons.); and *GTE North*

Inc., Order, Docket Nos. 93-0301 and 94-0041 (cons.), October 11, 1994, pp. 8-13, 1994 Ill. PUC LEXIS 436, *16-*26, *affd. sub nom. Citizens Utility Board, et al. v. Illinois Commerce Comm'n,* Order of July 12, 1995, Appellate Court Docket Nos. 4-94-1103, 4-94-1104, and 4-94-1122 (cons.), *cert den*. December 6, 1995, Sup. Ct. Docket No. 79931, Petition of GTE North. *See also Citizens Utility Board v. Illinois Commerce Comm'n,* 166 Ill. 2d 111, 132 (1995) [Commission is unauthorized to depart drastically from practices established in earlier orders] and *Mississippi River Fuel Corp. v. Illinois Commerce Comm'n,* 1 Ill. 2d 509, 514 (1953) [long-term consistent actions by the Commission can constitute a binding statutory construction])

<u>Alleged Ground No. 2</u>

The Companies' next new fact or changed circumstance is that they have shown that the "pension asset" is owned by the utility, with employees being the beneficiaries of the trust. (Id., p. 27) Staff has already addressed the argument that ownership of the pension asset is not determinative of ratemaking treatment. (Staff Ex. 14.0, pp. 5 – 6; Staff IB, pp. 33-34: Staff RB, p 30) It is not important who owns the assets in the pension trust fund. The important question is whether the alleged "pension asset" was created with funds from shareholders. Ownership is not determinative of ratemaking treatment. As Staff witness Pearce explained in rebuttal testimony (Staff Ex. 14.0, p. 5), Peoples Gas owns the entire Compressed Natural Gas ("CNG") fueling station, but because it was constructed in part using funds from a federal Clean Cities grant administered by the City of Chicago, the Company may not include in its rate base the entire cost of the CNG fueling Station. In fact, the Company only sought to include in rate base the cost of the fueling station not covered by the federal grant. (NS-PGL Ex. 44.0, p. 1)[4] Therefore, even if Peoples Gas or North Shore Gas owns the alleged "pension asset," and owns the assets in the pension trust fund, which Staff does not concede, it is simply not relevant to determining whether the alleged "pension asset" should be included in rate base. (Staff Ex. 14.0, pp. 5-6)

Furthermore, Staff's position is (and has been) that first, there is no "pension asset"; second, the "pension asset" is a mathematical derivation of the underfunded status of the plan (a liability) offset against the regulatory asset, which can only be reflected on the Company's books to the extent *it is expected to be collected from ratepayers through future rates*. Therefore, the alleged "pension asset" is created with monies that will be collected from ratepayers, not shareholders. A regulatory asset, by its definition in the Uniform System of Accounts for Gas Utilities Operating in Illinois[5], only exists due to the rate actions of this Commission and represents costs that would have been included in net income in one period but for purposes of developing rates, is collected in the costs for utility services in a different period.

<u>Alleged Ground No. 3</u>

The Companies' next ground is that customers, by paying their bills, do not pay for the pension asset and that the rates on which their bills are based reflect the accrual of pension expense. (NS-PGL BOE, p. 28) This argument should be disregarded. The

[4] Subsequent to making its initial filing, Peoples Gas on its own withdrew the CNG station from rate base. (PO, p. 9; NS-PGL Ex. 41.0, 2)

[5] 83 Ill. Adm. Code 505.10 adopted 18 CFR 101, as of June 15, 2006. 18 CFR 101 provides Definition 31 – Regulatory Assets and Liabilities.

alleged “pension asset” represents funds that will be provided through future revenue streams from ratepayers paying their bills; the alleged “pension asset” does not represent any investment from investors. Staff has repeatedly addressed the fact that ratepayers pay the ongoing cost of pension and OPEB benefits through the operating statement, therefore, they—not shareholders—supply the monies used to fund the pension. As Staff witness Pearce testified in direct testimony,

> The mere fact that cash collected from ratepayers is later remitted to the pension trust fund does not somehow make those funds “supplied by investors,” as Ms. Phillips seems to imply. The Companies must show specific contributions to the pension trust fund that come directly from shareholders. (Staff Ex. 4.0, pp. 5 – 6)

(Staff RB, pp. 30-31)

<u>Alleged Ground No. 4.</u>

The Companies’ next new alleged ground is that a portion of what ratepayers pay in rates collected by the utilities includes a cost of capital, and thus is shareholder’s equity, to the extent it is not paid out in dividends. (NS-PGL BOE, p. 28) The Companies made this same argument in the 2011 case (Final Order, Docket No. 11-0280/0281, January 10, 2012, p. 29) yet they suggest in their BOE that this is a new fact or new circumstances which should cause the Commission to reconsider its prior decisions. The Companies then acknowledged in their BOE and acknowledged in their initial brief that the Commission has considered and rejected the argument that a portion of amounts collected from customers that ends up as net income is retained earnings, and thus is part of shareholder’s equity. (NS-PGL IB, pp. 53-54; NS-PGL BOE, p. 28) The Companies falsely claim that Staff has ignored this ground in this case. (NS-PGL BOE, p. 28) The Companies are wrong, as Staff addressed the argument in its reply brief. (Staff RB, pp. 31-32) Putting that aside, the implication appears to be that since some of the monies that ratepayers pay to utilities ultimately gets paid to shareholders as dividends or is made part of retained earnings that such monies, therefore, are not ratepayer funded. This claim is obviously illogical and flawed and is not supported by the evidence in the record. The Companies fail to recognize that they have offered no evidence in this record that they are not paying dividends to shareholders. In fact, the evidence in the record suggests the exact opposite. Even the Companies' rate of return witness Mr. Moul assumes in his cost of equity analysis that for the foreseeable future the Companies will be making streams of dividend payments to shareholders[6]. (NS-PGL IB, p. 140) Since dividends are being paid to shareholders, the Companies' argument that a portion of rates representing a cost of capital has somehow created the alleged "pension asset" is without support in the record. In addition, this argument by the Companies does not address the fact that ratepayers should not have to provide a return on an asset that represents future collections from ratepayers. (Staff RB, pp. 31-32)

<u>Alleged Ground No. 5.</u>

The Companies' final "new ground" is that cumulative pension contributions have exceeded cumulative pension expense, (NS-PGL BOE, p. 28) but even the Companies seem to acknowledge this is not really a new ground since the same point was made by the Companies in the 2011 rate case. (*Id*., p. 28) Staff responded in detail to this

[6] The Companies used a DCF analysis among other analysis to estimate cost of common equity. DCF analysis assumes that the market value of common stock equals the present value of the expected stream of future dividend payments. Since a DCF model incorporates time-sensitive valuation factors, it must correctly reflect the timing of the dividend payments that stock prices embody. (Staff IB, p. 73)

argument in its testimony and reply brief in this case. Staff pointed out in its reply brief that the Companies' assertion that pension contributions exceeded expense by $77,546,609 during the period October 1, 1995 – December 31, 2013 (NS-PGL IB, p. 54) presents a misleading assessment of the impact on ratepayers. The $77,546,609 difference between total pension expense of ($24,080,194) and total pension contributions of $53,466,415 for the 18-year period (1995 – 2013) (Staff Ex. 14.0, Att. A, p. 7) is due to negative amounts of pension expense in the years 1996 – 2003. Negative pension expense typically results when the expected return on plan assets exceeds other elements that make up pension expense. However, ratepayers did not receive the benefit of these negative expenses, because no rate case was filed that reflected the negative amounts in the revenue requirement. (Staff IB, pp. 36-38) Moreover, Peoples Gas filed several rate cases since its rate case in Docket No. 07-0242. As shown in the table below, in the overwhelming majority of these rate cases, the Companies' pension expenses recovered from ratepayers through base rates exceeded actual pension contributions—the reverse of what the Companies claim. (Staff Ex. 14.0, p. 11) On a total basis pension expense of $84,257,459 exceeds pension contributions of $17,164,995 by $67,092,464. In terms of magnitude, total pension expense is almost five times greater than the pension contributions.

General Rate Case	**Test Year**	**Pension Expense**	**Pension Contribution**
Docket No. 07-0242	Historic test year ended 9/30/06	$ 11,507,532	$ 16,207,282
Docket No. 09-0167	Future test year ended 12/31/10	$ 8,015,677	$ 121,123

Docket No. 11-0281	Future test year ended 12/31/12	$ 26,311,141	$ 499,673
Docket No. 12-0512	Future test year ending 12/31/13	$ 38,423,109	$ 336,917
Total		**$ 84,257,459**	**$ 17,164,995**

Source: Companies Response to DR BAP 23.01, Staff Ex. 14.0, Att. A.

Shareholders did not provide a higher level of contributions than the amount of pension expense that was reflected in rates in three of the four years shown above. The table above supports Staff's contention that ratepayers-- not shareholders-- have supplied the funds and will continue to supply the funds for employee pension benefits. The Commission should reject this unsubstantiated and highly inaccurate claim that the Companies have used to justify inclusion of the alleged "pension asset" in rate base. (Staff Ex. 14.0, pp. 10 – 12) (Staff RB, pp. 32-34)

As noted by Staff previously, it is unreasonable for the Utilities to net the pension liability with a regulatory asset that reflects the recognition of assured future recovery from ratepayers of the pension expense, in order to reflect an alleged "pension asset" in rate base. This novel treatment leads to the absurd result of making ratepayers pay utility shareholders a return on amounts that ratepayers will pay the utility in the future. (Staff Ex. 14.0, pp. 7 – 9)

The Companies have never established that the so-called "pension asset" was not created with funds collected from or to be collected from ratepayers. It is an uncontested fact that ratepayers pay for ongoing, periodic pension expense and other post-retirement benefits—not the shareholders. The Companies admit this fact. (*Id.*)

Accordingly, the Commission should accept the PO's conclusion adopting Staff's proposal to remove the alleged "pension asset" from the Companies' rate base regardless of whether a year end or average rate base is adopted. In so doing, the Commission is appropriately rejecting the novel argument that ratepayers today should be forced to pay utility shareholders a return on amounts that ratepayers will pay the utility again in the future. Moreover, the Companies have presented no new facts or evidence in the instant proceeding that would warrant a different conclusion from the Commission in this proceeding than it has reached in its orders for the previous three rate cases, one of which, 09-0166/0167 (Cons.), was upheld on appeal as discussed above. (*Id.*) (Staff RB, p. 34)

Finally, the Companies argue in the alternative that the Commission should allow a return by North Shore on pension contributions of $4.0 million for 2009 and $11.1 million in 2010 which they claim customers did not fund. They further argue in the alternative that the Utilities' OPEB liabilities should be excluded from the Utilities' rate bases. (NS-PGL BOE, p. 29) The Commission has rejected both of these same arguments before and should do so again. The Companies' argument that a return should be provided on pension contributions made by North Shore in 2009 and 2010 has the same defect as the Companies' main argument seeking recovery on a "pension asset." The Companies have not shown that the funds for those pension payments did not come from ratepayers. The Companies raised this exact same alternative argument in their 2011 case (Order, Docket Nos. 11-0280/0281, January 10, 2012, p. 28) and it was rejected by the Commission. With respect to their alternative OPEB liability argument, the same argument was made in the 2007, 2009, and 2011 rate cases and rejected by the Commission (Order, Docket Nos. 07-0240/0241 (cons.), February 5, 2008, pp. 32 and 36 ; Order, Docket Nos. 09-0166/0167 (cons.), January 21, 2010, pp. 29 and 36; Order, Docket Nos. 11-0280/0281 (cons.), January 10, 2012, pp. 28 and 33)

If the Commission believes that it needs to specifically respond to the Companies' five grounds and alternative arguments set forth in the Companies' BOE. (*Id.*, pp. 27-30), Staff provides some language for the Commission to consider which modifies the PO consistent with the arguments above.

<u>Proposed Modification</u>
(PO, p. 90)

Commission Analysis and Conclusion

The Commission finds that the Utilities' pension assets should not be included in rate base for the reasons stated in its past Orders. The Commission concludes, however, that the OPEB liabilities should be included in rate base, to be consistent with the prior rulings on the pension assets.

<u>While the Companies argue there are five additional grounds for the Commission to reach a different conclusion than it has reached in its past orders for the Companies, no such credible grounds exist. First, the Commission does not agree as a matter of law that the rationale for its prior decisions is wrong. The case *Bd. of Pub. Utility Commissioners,* is not on point since it is essentially a retroactive ratemaking case. No such retroactive ratemaking is taking place by adopting Staff's adjustment. Second, as Staff pointed out ownership of the pension asset is not determinative of ratemaking treatment. It is not important who owns the assets in the pension trust fund. The important question is whether the alleged "pension asset" was created with funds from shareholders. Third, the Companies' argument that customers, by paying their bills, do not pay for the pension asset and that the rates on which their bills are based reflect the accrual of pension expense, is rejected. As Staff pointed out the alleged "pension asset" represents funds that will be provided through future revenue streams from ratepayers paying their bills and therefore the alleged "pension asset" does not represent any investment from investors. Fourth, while the Companies claim that a portion of what ratepayers pay in rates collected by the utilities includes a cost of capital, and thus is shareholders' equity and therefore, the "pension asset" represents shareholder funds, they fail to recognize that the Companies pay out dividends to their shareholders and therefore, the pension asset is not created with shareholder funds as the Companies suggest. Fifth, the final argument by the Companies that the cumulative pension contributions have exceeded cumulative pension expense, not only has been rejected by the Commission before, but as Staff points out in this case, presents a misleading</u>

assessment of the impact on ratepayers. The difference between pension contributions and pension expense is due to negative amounts of pension expense in the years 1996 – 2003. As Staff pointed out negative pension expense typically results when the expected return on plan assets exceeds other elements that make up pension expense. However, ratepayers did not receive the benefit of these negative expenses, because no rate case was filed that reflected the negative amounts in the revenue requirement. Moreover, Peoples Gas filed several rate cases since its rate case in Docket No. 07-0242. As shown by Staff witness Pearce in the overwhelming majority of these rate cases, the Companies' pension expenses recovered from ratepayers through base rates exceeded actual pension contributions—the reverse of what the Companies claim. Shareholders did not provide a higher level of contributions than the amount of pension expense that was reflected in rates in three of the four years shown by Ms. Pearce. Ms. Pearce has shown that ratepayers-- not shareholders-- have supplied the funds and will continue to supply the funds for employee pension benefits.

Finally, with respect to the Companies' two alternative positions, first regarding pension contributions by North Shore, that argument is rejected for the same reason that a "pension asset" is not included in rate base. The Companies have failed to show that the source of the pension contributions did not come from ratepayers. With respect to the OPEB liability, the OPEB liability represents the amount of expense that has been recovered in rates and not yet contributed to the pension plan by the Company. Therefore, the OPEB liability represents a cost-free source of capital to the Company and must be a reduction of rate base (i.e., included in rate base) as the Commission has found on numerous occasions for the Companies and other utilities in the state.

* * *

5. Net Operating Losses

The exceptions put forth by the Companies in regard to the 2012 NOL are utterly insufficient and lack the necessary calculations to support the proposed changes. (NS-PGL BOE, pp. 12 and 30) More to the point, the Companies provided absolutely no supporting revenue requirement schedules to reflect the impact of the 2012 NOL on the test year revenue requirements if any level of rate increase is approved. (NS-PGL Exceptions, pp. 92 – 101) The Companies' proposed technical exceptions regarding the 2012 NOL are untenable and cannot be implemented even if the Commission is amenable. The reason is because those technical changes are based on the revenue requirement schedules as they are presented in Appendices A and B attached to the ALJPO. In order for those technical changes to remain correct in the final revenue requirements that are approved by the Commission, there could be no other changes to the Appendices attached to the final order. In other words, the technical exceptions proposed by the Companies would only be proper if the Commission accepted Appendices A and B with no further changes between the ALJPO and the final Order. While that is a possibility, it is extremely remote. The Companies themselves propose technical exceptions 2, 3, 4, 8, and 9 which recommend changes to the calculations in the ALJPO's Appendices. (NS PGL BOE, p. 75) Instead, the Commission is much more likely to accept some adjustments as they are reflected in the ALJPO and to change or reject others. Therefore, even if the Commission were to just adopt the technical changes proposed by the Companies in their BOE, the appendices attached to the final order would contain errors. (Staff BOE, pp. 14 - 18) Accordingly, Staff maintains its position that the 2012 NOL cannot be accurately reflected in the final revenue requirement schedules that are approved by the Commission because there is insufficient evidence in the record to accurately reflect the 2012 NOL and all its derivative impacts. *(Id.)*

6. Accumulated Deferred Income Taxes

a. Appropriate Methodology to Reflect Change in State Income Tax Rate

The Companies' BOE takes issue with the ALJPO regarding the appropriate methodology to reflect changes in the state income tax rate. (NS-PGL BOE, pp. 31-39) Staff concurs with the Companies that good cause has not been shown by the Intervenors for the Commission to deviate from past Commission orders for the Companies on this issue. The ALJPO appropriately cited to the order in Docket No. 83-0309 (Docket Re Accounting Treatment of the Deferred Tax Reserve) indicating that the use of the Average Rate Assumption Method ("ARAM") can be rebutted for good cause; however, the ALJPO incorrectly concluded that good cause was shown in the instant proceeding by accepting the position of the AG and CUB-City on this matter. (ALJPO, p.112) Staff witness Pearce did not take issue with the Companies' application of the method approved in Docket No. 83-0309. (Staff Ex. 14.0, pp. 21-22) Staff would note that the AG and CUB-City rely on the recent Commission Orders in two formula rate ("FR") proceedings which were filed pursuant Section 16-108.5 of the Illinois Public Utilities Act ("Act). In particular, they rely on Ameren Illinois Company's 2012 FR proceeding order (Order, Docket No. 12-0293, December 5, 2012, p. 97) and Commonwealth Edison Company's 2012 FR proceeding order (Order, Docket No. 12-0321, December 19, 2012, p. 33) as the basis for their proposal to change a long-standing Commission-approved methodology of accounting for changes in tax rates. (ALJPO, pp. 104 – 106 and 111 - 112) In Staff's opinion, the facts in the FR proceedings are not necessarily comparable to the facts of the instant proceeding. To wit, the FRs are filed pursuant to Section 16-108.5(d) of the Act and are subject to annual reconciliation proceedings. The rate increases requested in the instant proceedings were filed pursuant to Section 9-220(h) and (h-1) and Section 9-201 of the

Act, a traditional rate proceeding to which Docket No. 83-0309 has been long applied. Notably, traditional rate cases are not subject to annual reconciliations and the rates remain in effect until such time as the utilities request a rate increase. Accordingly, Staff believes the conclusions reached in the FR proceedings should not necessarily apply to the instant proceeding. Therefore, Staff concludes that the two recent FR orders do not constitute sufficient cause for changing the long-established methodology that has been consistently applied by the Utilities in their traditional rate cases since Docket No. 83-0309 was approved. (ALJPO, pp. 104)

b. **Repairs Deduction Related to AMRP projects**

c. **Bonus Depreciation**

d. **Derivative Adjustments from Contested Adjustments**

D. **Accumulated Depreciation (Uncontested Except for Derivative Adjustments from Contested Adjustments)**

V. OPERATING EXPENSES

A. **Overview/Summary/Totals**

1. **North Shore**

2. **Peoples Gas**

B. **Potentially Uncontested Issues (All Subjects Relate to NS and PGL Unless Otherwise Noted)**

1. **Administrative & General**

a. **Interest Expense on Budget Payment Plan**

b. **Interest Expense on Customer Deposits**

c. **Lobbying expenses**

d. **Social and Service Club Dues**

e. **Executive Perquisites**

f. **Consulting Expense – SIG Consulting**

g. **Employee/Retiree Perquisites – Awassa Lodge**

h. **Update to Pension and Benefits**

i. **Updated IBS Return on Investment**

<u>NS-PGL Technical Exception No. 5 – Update to IBS Return on Investment</u>

The Utilities propose in their BOE to update the calculation of the rate of return on investment charged by IBS. (NS-PGL BOE, pp. 39-40) Staff avers this proposal is nothing more than a substantive adjustment proffered in the form of a technical exception. Staff objects to this exception based on the fact that it is new information offered after the record has been marked ‘heard and taken’. Accordingly, it was not subject to discovery or cross-examination and parties are deprived of due process if the proposed methodology is reflected in the final order. Therefore, it should be rejected.

j. Costs to Achieve Amortization

2. Uncollectible Account Expense Included in Base Rates

3. Depreciation Expense

a. WAM System

b. CNG Plant

4. Income Tax Expense – Changes in Interest Expense on Debt Financing

5. Revenues

a. Sales and Revenue Adjustment by Service Classification

6. Interest Synchronization (methodology on derivative adjustments)

C. Potentially Contested Issues (All Subjects Relate to NS and PGL Unless Otherwise Noted)

1. Incentive Compensation (Falls in Multiple Categories of O&M)

2. Wage Increase Corrections

3. Non-union Base Wages (Falls in Multiple Categories of O&M)

NS-PGL Exception No. 8

The Companies attempt to discredit the studies cited by Staff as support for its position to decrease the amount of non-union base wage increase to be recovered in base rates. (NS-PGL BOE, pp. 47-49) Staff provided in-depth discussion in testimony as to why the documentation supporting its position was superior to that provided by the Companies. (Staff Ex. 13.0, pp. 9-12) The PO appropriately concluded that the evidence and analysis presented by Staff are more reasonable than that proposed by the Companies.

However, Staff agrees with the Companies that revisions to the adjustments adopted in the PO are necessary to properly reflect a 1.17% reduction of the Companies' 2012 non-union wages. (NS-PGL BOE, p. 43) Staff concurs with the amounts and language reflected in the Companies' Alternative 2 to Exception 8. (NS-PGL Exceptions, pp. 142-143)

4. Vacancy Adjustment (Falls in Multiple Categories of O&M)

5. Distribution O&M

a. Plastic Pipefitting Remediation Project

Peoples Gas takes exception to the PO on the disallowance of costs for Peoples Gas' Plastic Pipefitting Remediation Project ("PPRP"). (NS-PGL BOE, pp. 49-50) Peoples Gas argues that the PPRP costs are reasonable and prudent because the most reasonable and safest approach was to replace the pipefittings. (*Id*., p. 49) The Companies' BOE misses the mark on this issue. Staff did not argue that the plastic pipefittings should not be replaced. (Staff Ex. 6.0, p. 9) The issue is whether such a remediation program should ever have been necessary, not whether it was appropriate to replace the pipefittings. As Staff witness Seagle testified "[i]f Peoples Gas had initially complied with the Commission's Rules, in particular Part 590, the Company would not have incurred the costs associated with the PPRP." (*Id.*, pp. 9-10) Staff witness Burk, Manager of the Commission's Pipeline Safety Program in the Safety and

Reliability Division, supported Mr. Seagle's adjustment. Pipeline safety expert, Burk testified that:

> [p]ipeline operators are allowed to seek special permits that allow for installation of materials or components that have not been previously approved or manufactured and marked according to an incorporated standard; however, the requirements of 49 CFR Section 190.34(b) state that the operator must seek the special permit and demonstrate that safety will not be compromised <u>prior to installing</u> the non approved material or component. (Staff Ex. 19.0, Attachment 3) Special permits include specific installation and monitoring requirements that must be agreed to prior to installation. ... During a meeting requested by PGL and held at the Commission's Springfield office on September 26, 2011, PGL informed Staff that the fitting installed in the Company's system were not marked as required and failed to provide documentation as to the standard to which the fitting were manufactured.

Clearly, if Peoples Gas had initially complied with the Commission's Rules, in particular Part 590, the Company would not have incurred the costs associated with the remediation program (Id.) to replace fittings the Company readily admits were not properly marked to demonstrate that they were manufactured to the required specifications and in compliance with the requirements of the CFR. (Staff Ex. 19.0, p. 6) Based upon the above, the ALJs appropriately rejected Peoples Gas' arguments and agreed with Staff that the costs of Peoples Gas' PPRP should be disallowed. (PO, p. 143)

Finally, the implication by Peoples Gas in its BOE that it was even an option for it to keep the plastic pipefittings in the system with no replacement ("Peoples Gas continues to maintain that the most reasonable and safest approach is to replace the pipefitting." (NS-PGL BOE, p. 49)) was refuted by pipeline safety expert Burk who testified that his "extensive experience working with PHMSA allows me to state with complete confidence that, if the Companies would have sought a special permit to allow the fittings to permanently remain in the system, PHMSA [Pipeline and Hazardous

Materials Safety Administration] would not have granted that permit." (Staff Ex. 19.0, p. 3)

Based upon the above and the arguments previously set forth in Staff's testimony and briefs, the Companies' exception to the PO on this issue must be rejected by the Commission.

b. Legacy Sewer Lateral Cross Bore Program

c. New Chicago Department of Transportation Regulations

6. Productivity Adjustment

7. Administrative & General

a. Adjustments to Integrys Business Support costs

b. Advertising Expenses

c. Charitable Contributions

Staff disagreed with the PO's conclusion to reject Staff's adjustment to disallow charitable contributions made to Illinois colleges and universities outside of Peoples Gas' service territory. (Staff BOE, p. 27) Respectfully, it is Staff's position that the PO misstated and misinterpreted its position with respect to a utility's right to recover expenses for charitable contributions to organizations receiving donations outside of the utility's service territory.

The PO states that the Commission agrees with the Utilities' reasoning regarding the benefits provided by Illinois universities and rejects Staff's adjustment. (PO, pp. 166-167) However, the Utilities reasoning is based solely on the premise that "Illinois universities have in the past and currently provide educated utility workers to serve customers and an educated citizenry within the service territory…" (NS-PGL Ex. 26.0,

p. 9) This one statement should not be construed as sufficient evidence demonstrating that the subject contributions provide benefits to ratepayers.

Staff contends that despite Peoples Gas' conclusory statement that its charitable contributions to colleges and universities located outside of its service territory are reasonable and a benefit to Peoples Gas ratepayers (Staff Ex. 3.0, p. 21), the Company failed to provide any tangible evidence consistent with, and required by, the Commission's recent orders. Moreover, the PO does not specifically identify what the tangible benefits in fact are, which is essential to making the determination of whether the Company met its burden in showing the benefit to the public as required by the Commission. (PO, p. 174)

The record does not indicate the number of utility workers serving customers within the service territory who were educated by Illinois universities outside of the Utilities' service territory. The record also does not indicate the specific benefits that Illinois universities outside the Utilities' service territory have provided to ratepayers. As such, the PO could not and does not identify any specific benefits that Illinois universities outside the Utilities' service territory actually provide to ratepayers. It is the Companies' burden to show that the costs at issue are just and reasonable. ("… the burden of proof to establish the justness and reasonableness of the proposed rates or other charges, classifications, contracts, practices, rules or regulations, in whole and in part, shall be upon the utility. .." (220 ILCS 5/9-201(c))

As highlighted in the PO, Staff contends that its proposed adjustment is consistent with the Commission's recent orders (Docket Nos. 12-0321, 10-0467, 11-0721, and 12-0001) that disallow contributions to organizations outside of a utility's service territory. (PO, p. 173, *citing* Staff Ex. 13.0 at 21) However, it is also important to point out that Staff witness Ostrander's testimony specifically highlighted the Commission's findings on the burden that must be met in order to demonstrate that there is *in fact* a benefit to the utility service territory. The Commission explained:

> While it is possible that a donation made to an organization outside of a utility's service territory may in some way benefit the public within the utility's service territory, for a utility to recover that expense, the donations must have some **showing** of the benefit to the public within the utility's service territory.

(Staff Ex. 13.0 at 21)(Emphasis added) This information and other pertinent information is necessary to evaluate if any tangible benefits are provided to ratepayers, but such information is not in the record for this proceeding.

For these reasons, Staff reasserts that the recommended disallowance, as stated in its BOE, of test year charitable contributions made by Peoples Gas to organizations outside the company's service territory is appropriate and should be adopted by the Commission. Staff therefore recommends the language of the PO on pages 166-167 be amended as set forth in Staff's BOE. (Staff BOE, pp. 28-29)

d. Institutional Events

8. Depreciation

a. Bonus Depreciation

b. Derivative Adjustments from Contested Adjustments

9. Rate Case Expenses

D. Taxes Other Than Income Taxes and Invested Capital Taxes (Payroll) (Uncontested Except for Invested Capital Tax and Derivative Adjustments from Contested Adjustments)

1. Invested Capital Tax Computation and Derivative Adjustments

E. Income Taxes (Including Interest Synchronization) (Derivative Adjustments from Contested Adjustments)

1. Appropriate Methodology to Reflect Change in State Income Tax Rate (see also Section IV.C.6.a.)

F. Gross Revenue Conversion Factor

1. Methodology

2. Late Payment Charge Ratio

G. Net Operating Loss (Derivative Adjustment based on NOL Tax Asset)

VI. RATE OF RETURN

A. Overview

B. Capital Structure

C. Cost of Short-Term Debt

D. Cost of Long-Term Debt

E. Cost of Common Equity

Outside of a single passing reference, the Companies' BOE regarding the cost of common equity (Section VI.E.) contains no discussion whatsoever of the actual ROE analyses that were performed. Rather than discuss those analyses, which were designed to estimate the cost of common equity specifically for Peoples Gas and North Shore, the Companies focus exclusively on authorized ROEs for *other* companies, in *other* jurisdictions, at *other* times during *other* market environments.[7] This should not come as a surprise, however, since those analyses – both Staff's and the Companies' own[8] – demonstrate that the true investor required return on the Companies' common equity is approximately 9.00%, instead of the 10.00% they would like to receive.

Staff has already fully debunked the Companies' arguments regarding other authorized ROEs and incorporates those arguments here. (Staff IB, pp. 77-78; Staff RB, pp. 70-72) Nonetheless, Staff's RBOE addresses several specific arguments the Companies make in their BOE in their continuing attempt to justify a higher ROE related to: (1) a comparison of current ROE estimates to those in the last proceeding and (2) the relationships between equity premiums, interest rates, and ROEs.

1. Comparison to ROE estimates in the last proceeding

The Companies claim that their cost of common equity is rising. (NS-PGL BOE, p. 63) However, as Staff accurately noted in its RB, Companies witness Moul's own recommendation in this proceeding is lower than his recommendation in the Companies' last rate case, indicating a falling ROE. (Staff RB, pp. 58-59) Incredibly, the Companies argue that it is wrong to compare the Companies' actual

[7] Although the Companies decry Staff's repetition of this statement, they cannot deny its veracity.

[8] When corrected to remove the inappropriate leverage adjustment that this Commission has repeatedly rejected.

recommendations between the two cases. That is, the Companies are now suggesting that Staff supposedly erred in assuming that the Companies stand by their ROE recommendations as estimates they actually believe to be correct. Instead, the Companies suggest that their model results rose 48 basis points from the 2011 proceeding to the instant docket.

However, a simple review of the facts in the two proceedings shows their proposed comparison to be nothing more than an exercise in deception. The table below shows the Companies' initial results from both the 2011 proceeding and the instant docket.

Initial Results

		11-0280/0281	12-0511/0512
Gas/Delivery Group:	DCF	9.67%	8.98%
	Risk Premium	11.25%	11.00%
	CAPM	11.21%	11.17%
Average		10.71%	10.38%

(Order 11-0280/0281 (Cons.), January 10, 2012, p. 112; NS Ex. 3.0; p. 47; PGL Ex. 3.0; p. 47) As one can plainly see, every individual analysis produced a lower result in the current docket than in the prior case, with the average falling by 33 basis points (10.71% - 10.38% = 0.33%).

Further, during the course of each proceeding, the Companies revised their cost of equity estimates, obtaining the follow results:

Revised Results

		11-0280/0281	12-0511/0512
Gas/Delivery Group:	DCF	9.03%	8.98%
	Risk Premium	11.25%	11.00%
	CAPM	11.56%	10.03%
Average		10.61%	10.00%

(Order 11-0280/0281 (Cons.), January 10, 2012, p. 112; NS-PGL Ex. 39.0; p. 2) As one can plainly see with the revision, too, every individual result is lower in the current docket than in the prior case, with the average falling by 61 basis points (10.61% - 10.00% = 0.61%). Thus, whether one looks to the specific model results or their actual ROE recommendations, the conclusion is the same: the Companies' analyses support a reduction to the authorized ROE.[9]

Undeterred by those facts, the Companies claim that the results actually rose from 10.61% to 11.09%. However, the only way the Companies can claim that their cost of common equity results have risen since their last proceeding is to blatantly manipulate the data. The Companies distorted the results in two distinct ways. First, despite revising their analyses in *both* proceedings, they now propose to compare the *revised* result in the 2011 docket to the *initial* result in this proceeding. That is, since their revisions decreased the results in both proceedings, they chose to compare the lowest 2011 results to the highest 2012 results – hardly a forthright comparison. But, as the tables above show, even that apples-to-oranges comparison was not sufficient, as the initial result in this proceeding is still 23 basis points lower than the revised result in the 2011 docket (10.61% - 10.38% = 0.23%). Thus, needing to adjust farther, they also included the DCF model result in their 2011 recommendation while excluding the DCF result from their 2012 recommendation – this, despite recommending the exact *opposite*

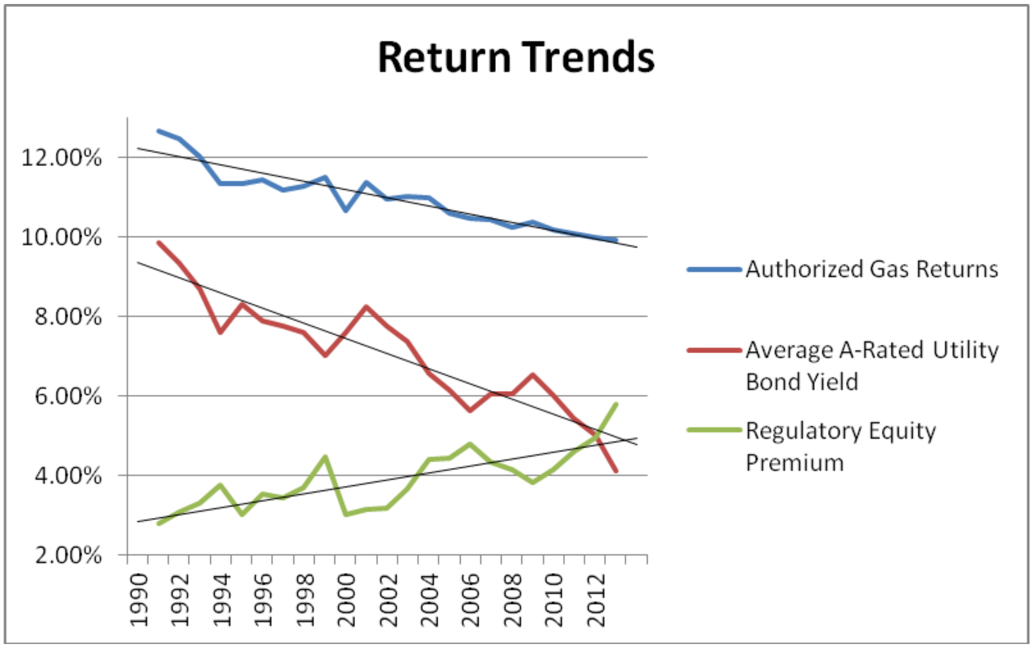
[9] Even the outside authorized ROEs the Companies rely on so heavily fell by 38 basis points from their last case to this proceeding. (Order 11-0280/0281 (Cons.), January 10, 2012, p. 112; NS-PGL IB, pp. 130-131)

in each case.[10] Both their inconsistent comparison of initial and revised results and their inconsistent use of DCF results serve to give the appearance of a lower 2011 result and a higher 2012 result, without which they could not claim an increasing ROE. Representing such an "analysis" as legitimate is an insult to the Commission.

2. Equity Premiums, Interest Rates, and Authorized ROEs

In its Initial Brief, the Companies argued that because the equity premium between interest rates and other authorized ROEs for A-rated natural gas utilities is rising, their cost of equity is increasing. (NS-PGL IB, p. 131) That is, they suggest there is a positive correlation between equity premiums and authorized ROEs. However, the Companies' own data demonstrates that the opposite is true. Staff presented the following graph of that data showing that, while authorized ROEs and interest rates are *directly* related, authorized ROEs and equity premiums are *inversely* related. (Staff RB, pp. 60-63) Thus, the Companies' own data supports Staff's conclusion that falling interest rates suggest a lower ROE while disproving the Companies' argument that rising equity premiums suggest a lower ROE.

[10] They explicitly recommended "that the DCF results be discounted or excluded" in the 2011 proceeding and explicitly "included the DCF model" in the current proceeding. (Order 11-0280/0281 (Cons.), January 10, 2012, p. 112; NS Ex. 3.0; p. 47; PGL Ex. 3.0; p. 47)



In defense of their premise, the Companies now claim that they were not referring to the last 20+ years, but only the last five. (NS-PGL BOE, pp. 63-66) But that is not true. This entire argument arose from Staff witness McNally's presentation of data showing that interest rates have been steadily trending downward since 1990 and are at the lowest they have been in that time. (Staff Ex. 15.0, pp. 9-10) Claiming to "complete the picture" of "how authorized utility returns have reacted to that trend," Mr. Moul then presented equity risk premiums for 1990-2012, which he derived from authorized ROE data. (NS-PGL Ex. 39.0, pp. 3-4) His response contained nothing whatsoever to indicate he believed we should focus on the last five years. That is a development that only comes now that the Staff has exposed the true complete picture that Mr. Moul chose to withhold, which supports a lower ROE.

Moreover, even if the Companies' most recent claim were true, it is a curious response on several counts. First, it raises the question of why they chose to present a graph four separate times in this proceeding that presents data for the last 22 years if they were truly only addressing the last five years of data. (NS-PGL Ex. 39.0, p. 4; NS-PGL IB, p. 131; NS-PGL RB, p. 133; NS-PGL draft PO, p. 92) Second, they never established why one should ignore relationships born out by 20+ years of data and focus only on the last five years. Finally, and most bizarrely, even if one focuses solely on the last five years of data, it still supports Staff's finding that interest rates are positively correlated with authorized ROEs while the equity premiums are inversely correlated. As shown unambiguously in the graph above as well as in the graph presented on page 64 of the Companies' BOE, in the last five years both interest rates and ROEs continue to fall while risk premiums continued to rise.

The Companies find it noteworthy that from 2008 to 2012 equity premiums rose 51% and interest rates fell by 37%, seeming to suggest that the rise in equity premiums has more than offset the fall in interest rates. They are wrong. Their comparison is irrelevant and misleading, as a result of inconsistent scaling.[11] The relevant comparison, with a consistent scale, would be a comparison of the absolute changes in terms of basis points rather than percentage changes. That comparison, shown in the table below, reveals that while the change in equity premiums was 197 basis points between 2008 and 2012, the change in A-rated utility bond yields was 240 basis points in that same period.

Year	Authorized Gas Returns	Average A-rated Utility Bond Yields	Regulatory Equity Premium
2008	10.37%	6.53%	3.84%
2012	9.94%	4.13%	5.81%
Difference	-0.43%	-2.40%	1.97%

[11] This is the same mathematical "phenomenon" seen in the example of a stock price rising from $50 to $100 compared to a stock price falling from $100 to $50. Although both changed by the same $50, the former represents an increase of 100%, while the latter represents a decrease of only 50%.

(Staff Cross Ex. 8) Thus, contrary to the Companies' implications, the change between 2008 and 2012 is actually greater for bond yields than for equity premiums. Because interest rates and equity premiums are added together to produce the ROE, the greater downward change in bond yields more than offsets the upward change in equity premiums, causing ROEs to <u>fall</u> by 43 basis points during that period, as even the Companies' BOE acknowledges. (NS-PGL BOE, p. 64) Thus, even in the five-year period the Companies' cherry-picked for their argument, the positive correlation between interest rates and authorized ROEs still holds, while the equity premiums and authorized ROEs are still inversely correlated.

The Companies go on to claim that the "strong direct correlation" between interest rates and ROEs no longer holds, and extrapolate from that that the direct relationship will <u>reverse</u>. (NS-PGL BOE, p. 65) That argument is both inappropriate and factually incorrect. First, their attempt to extrapolate statistical conclusions from the data they cite lacks supporting expert testimony and should be ignored. Second, as noted above, although the correlation might not be as strong in the short period that the Companies selected for examination as it has been in general, there is still a distinct direct correlation. Further, there is no evidence whatsoever that the direct relationship demonstrated by more than 20 years of data will reverse itself. To begin with, the Companies' entire argument simply assumes that a short-term weakening of the correlation during the short period they selectively chose will necessarily continue over the long term. But there is no reason to believe that is true – they certainly have presented no evidence to support that assumption. Moreover, even if that assumption were correct, they are mathematically incorrect to state that a weakening direct correlation will eventually turn into an inverse correlation.[12] Such an inverse relationship would mean that the ROE would rise as interest rates fall and vice versa. The absurdity of this assertion should be self evident, even to the untrained eye. Indeed, it is inconsistent with the Companies' own argument that interest rates will rise in the near future – if that were true, an inverse relationship would cause their ROE to fall, yet the Companies are claiming their argument supports a rising ROE. Thus, with no evidence whatsoever, the Companies' hypothetical argument assumes away the relationship revealed by 22 years of evidence and simply presupposes the exact opposite, in direct conflict with their own arguments.

Responding to Staff's observation that the equity risk premiums Mr. Moul had presented were overstated since their calculation reflects an average of all A rated utility bond yields, rather than just A- utilities like the Companies, the Companies argue that Staff has presented "no evidence to show that excluding 'A+' and 'A' rated utilities from the calculation of the regulatory equity premium would have made a material difference." (NS-PGL BOE, p. 65) The Companies' response is clearly insufficient to justify any reliance on those calculations. First, the idea that materially lower risk investments would not have a materially lower required return defies the core financial tenet of risk aversion. (Staff Ex. 5.0, pp. 18-19) This is not a matter of dispute. As Companies witness Moul states, "It is well recognized that the expected return on more

[12] Likewise, the Companies claim that if the "strong direct correlation" between interest rates and ROEs had held, equity premiums would have been flat. Again, this lacks any supporting expert testimony and again, perhaps as a result, it is factually incorrect. The Companies' claim would only be true if that "strong direct correlation" was actually a perfect correlation. Staff never suggested as much. One need look no farther than the graph above to see that even a strong direct correlation between interest rates and ROEs can exist when equity premiums have not been flat.

risky investments will exceed the required yield on less risky investments." (NS Ex. 3.13E, p. 2) Second, the Companies' response is nothing more than a feeble attempt to shift the burden of specifying the details of their own analysis onto Staff. Despite the fact that the Commission has rejected risk premium analyses repeatedly, the Companies put forth a second form of a risk premium analysis in their surrebuttal testimony. Having no further testimony through which to contribute critical missing details regarding that analysis into the record, Staff could only note that the risk premium in the second risk premium analysis was misspecified and, therefore, overstated. Significantly, the Companies do not deny the veracity of Staff's assertion, but merely attempt to shift the burden of proof onto Staff. However, it is the Companies' responsibility to demonstrate that their analysis is financially sound, especially when basic financial tenets indicate otherwise. They not did so. The Commission cannot rely on any analysis stemming from such a highly dubious foundation. Thus, the Companies' continued attempts to justify a higher ROE on the basis of those miscalculated and overstated risk premiums are of no value.

The Companies take exception to the PO's adoption of Staff's proposed rate design for the S.C. No. 1 Small Residential Heating class. However, the record evidence shows that the Commission should not change the PO's conclusion regarding the S.C. No.1 Small Residential Heating class. The PO accepts Staff's proposal to increase the recovery of non-storage related fixed costs from 67% to 68% through the customer charges for North Shore and from 54% to 61% for Peoples Gas. (PO, p. 237)

The Companies argue that there has been Commission support for recovering more fixed costs through fixed customer charges. (NS-PGL BOE, p. 69) However, Staff's proposal also increases the fixed cost recovery through fixed customer charges while allowing the Commission to proceed gradually and cautiously in the movement towards greater fixed cost recovery. Staff explained that if too much emphasis is placed on ensuring revenue requirements are met through higher fixed charges, other basic rate objectives will be inadvertently overshadowed. (Staff IB, p. 113) For example, consider the price signal customers would receive under the Companies' proposal. Peoples Gas customers under present rates currently pay 25.963 cents per therm for the first 50 therms and 11.806 cents per therm for anything over 50 therms. Peoples Gas' shifting of the distribution charge costs to the customer charge shifts the price signal customers receive from the distribution charge. Approximately 48% of total bills are attributed to 50 therms or less which, currently, is charged at the 25.963 cents per therm. Decreasing the current distribution charge from 25.963 cents per therm to 10.054 cents per therm in order to recover 80% of fixed costs in the distribution charge, as Peoples Gas proposed in rebuttal testimony, will not encourage customers to use less gas. Leaving the non-storage related demand costs in the distribution charge will ease the move to a flat rate while still encouraging conservation. (*Id*., pp. 106-107)

The Companies also argue that Staff has not explained why the Commission should observe the effects of bifurcation before increasing fixed cost recovery in fixed charges. (NS-PGL BOE, p. 70) However, Staff and the PO both point out that bifurcation of the S.C. No. 1 class will affect the two customer groups differently. (Staff IB, pp. 106-107; PO, p. 231) For example, the bifurcation produces the counter-intuitive result that the customer charge for the non-heating class decreases even though the percentage of fixed costs recovered through that customer charge increases under both Staff's and the Companies' proposals. Even under Staff's proposed 80% fixed cost recovery for the S.C. No. 1 non-heating class there is a dramatic decrease in the customer charge compared to the current combined S.C. No. 1 class. The decrease in the customer charge for non-heating customers, even at 80% fixed cost recovery, is a clear indication of the cost differences between heating and non-heating customers that were not apparent when the heating and non-heating customers were combined. Using the Companies' proposed direct testimony revenue requirement, the customer charge for the non-heating group would decrease from $22.00 per month to $14.48 for North Shore and from $22.25 per month to $13.63 for Peoples Gas. (Staff IB, p. 102) This occurs because the bifurcation produces a reduction in the customer charge for the non-heating class that more than offsets the increase that would result from either Staff's or the Companies' fixed cost recovery proposals. This is not the case for the heating class. The Commission should first wait and observe what effects the S.C. 1 split has on all of the Companies' residential customers before moving forward on significantly greater fixed cost recovery through the customer charge for the S.C. No. 1 HTG classes. (*Id.*, p. 107)

The Companies also state that their proposal recovers a specified percentage of fixed cost recovery through fixed charges and Staff's proposal recovers only non-storage related customer costs through the customer charge with all remaining non-storage related demand costs being recovered through a flat distribution charge. The Companies argue that under Staff's proposal the fixed cost percentage may differ under the final revenue requirement if the proportion of fixed customer and demand costs differs. (NS-PGL BOE, p. 71) Despite this argument, the Companies were able to meet Staff's fixed cost percentages when they recalculated the S.C. No. 1 HTG rates in their rebuttal testimony with their new rebuttal revenue requirement found on NS-PGL Exhibits 32.5 and 32.6. In any event, the Companies will rerun the cost-of-service study for the compliance filing in this case and will have the necessary customer and demand costs available to correctly calculate the rates under any fixed cost recovery mechanism. Additionally, as with any rate case, the plant investment, operation and maintenance, and all other inputs in determining the revenue requirement start to change as soon as the case is concluded. All numbers have the potential to change, including the Companies'.

<u>Response to NS-PGL, Technical Exception No. 7</u>

Staff agrees with the Companies' proposed Technical Exception No. 7. (NS-PGL BOE, pp. 71-72)

c. Service Classification Nos. 1 and 2, Alternative Conditional Straight Fixed Variable Rate Design

Response to NS-PGL, Exception No. 15

The Companies take exception to the PO's rejection of their proposed tariff language in S.C. Nos. 1 and 2 which is intended to address rate design that would take effect if a Court or the Commission invalidated Rider VBA. (NS-PGL BOE, p. 72) Even though the Appellate Court affirmed the Commission's order in Docket Nos. 11-0280/0281 (Cons.), the Companies argue the issue is not moot since the AG may still appeal the Appellate Court's March 29, 2013 decision affirming the Commission's authority to approve Rider VBA. (*Id.*) The Companies rely upon arguments made in their initial brief to support adoption of their conditional straight fixed variable ("SFV") rate design. Whether the issue is moot or not, the Companies' conditional SFV rate design tariff should be rejected which the PO did, for a number of policy reasons as well as rejecting it as a matter of law.

First, despite the Companies' claims to the contrary, they are not entitled to a guarantee of 100% fixed cost recovery. (NS-PGL IB, p. 160). As Staff argued in its reply brief, Staff does not believe the Commission's intent is to put rates in place for utilities so that a certain revenue requirement is <u>guaranteed</u>. Section 1-102(a)(i) of the Act states: "tariff rates for sale of various public utility services are authorized such that they accurately reflect the cost of delivering those services and <u>allow</u> utilities to recover the total costs prudently and reasonably incurred." (220 ILCS 5/1-102(a)(i)) The Commission recognized this in the Companies' last rate case when the Commission's final order stated that "[u]nder long established federal and Illinois constitutional law, and Illinois ratemaking law, a utility's rates must be set so as to allow it the opportunity to obtain full **recovery** of its prudent and reasonable costs of service, including its costs of capital. (Final Order, January 10, 2012, Docket Nos. 11-0280/0281 (Cons.), p. 5) (Emphasis added) (Staff RB, p. 82)

Second, Rider VBA and SFV rates are not equivalent substitutes for one another because they recover fixed costs in different proportions from different customers resulting in different rate impacts on customers. Rider VBA recovers any under or over recovery of fixed costs on a per therm basis. SFV rates would recover fixed costs on a per customer basis, which would affect small use customers greater than larger use customers. (Staff IB, pp. 108-109; Staff RB, pp. 82-83)

Third, even if the AG is ultimately successful in its appeal, Staff is still proposing greater fixed cost recovery through fixed charges. If the Commission believes greater fixed cost recovery is warranted, then Staff's proposed non-SFV rates would meet that requirement in a way that is more consistent with prior Commission orders and that considers gradualism and conservation. (Staff IB, pp. 108-109; Staff RB, p. 83)

Fourth, if events occur that lead the Companies to believe that a different rate structure would be more appropriate, the Companies are able to file rate cases when they deem it necessary to do so and in fact are currently required to file biennial rate proceedings in 2014 and 2016 under Section 9-220(h-1) of the Act. (Staff IB, pp. 108-109; Staff RB, p. 83)

Fifth, the Companies' use of customer demand forecasts for the 2013 test year should minimize some of the Companies' concerns about adequate cost recovery. The Companies' own witness Kevin R. Kuse testified that the Companies have used this same model in the past three rate cases and the model has performed well historically. (Staff IB, pp. 108-109; Staff RB, p. 83)

Sixth, if the Companies have two rates in place it will cause confusion for ratepayers or anyone else examining the tariff books. Including two rates on a tariff sheet whereby one of the rates will become effective only if a court determines that the other rate is illegal is not only confusing but premature. There is no known effective date in the Companies' proposed tariff language. Even if Rider VBA is not allowed by the court to continue, there may be legal disputes over what the correct effective date of the new customer charges and distribution charges should be. (*Id.*)

Seventh, Rider VBA is still in effect, has now been affirmed, and it is speculative as to whether it will be overturned on subsequent appeal by the AG.

Eighth, the Commission has already declined to approve 100% fixed cost recovery through a fixed charge. In fact, the Commission explained why it is important to leave a portion of fixed costs to be recovered through the volumetric rate:

> The Commission does not at this time approve recovery of all fixed costs in the monthly charges for two reasons. First, it is expected that leaving a portion of fixed costs to be recovered through the volumetric rate will encourage AIU to see ways to improve efficiency and otherwise cut costs. Second, as the number of AIU's customers grows, AIU should experience growing revenue. If all of its fixed costs were recovered through the monthly charge, AIU may arguably over-recover its fixed costs through the monthly charge.

(Order, Docket No. 07-0585 et al. (Cons.), September 24, 2008, p. 237)

Finally, even if the Commission rejects Staff's arguments against the Companies' conditional SFV tariff proposal which it should not, the Companies' proposal should be rejected as a matter of law. The Companies' conditional tariff proposals are inconsistent with Section 9-201 of the Act. Section 9-201(a) provides in part that:

> Unless the Commission otherwise orders, and except as otherwise provided in this Section, no change shall be made by any public utility in any rate or other charge or classification, or in any rule, regulation, practice or contract relating to or affecting any rate or other charge, classification or service, or in any privilege or facility, except after 45 days' notice to the Commission and to the public as herein provided. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules or supplements stating plainly the change or changes to be made in the schedule or schedules then in force, *and the time when the change or changes will go into effect*, and by publication in a newspaper of general circulation or such other notice to persons affected by such change as may be prescribed by rule of the Commission. The Commission, for good cause shown, may allow changes without requiring the 45 days' notice herein provided for, by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(220 ILCS 5/9-201(a)) (Emphasis added) Under the Companies' proposal, the tariff only takes effect if it ever does at some unknown date in time depending on events outside the Commission's control. This proposed conditional tariff is contrary to the plain language of Section 9-201(a) that a tariff must state "plainly the change or changes to be made in the schedule or schedules then in force, and *the time when the change or changes will go into effect*" (220 ILCS 5/9-201(a))(Emphasis added) Since no one knows when the conditional tariff will take effect, if it ever does, the conditional tariff fails to comply with the requirement of Section 9-201(a) that an effective date be provided in the tariff. Accordingly, the conditional proposed tariffs of North Shore and Peoples Gas should be rejected as a matter of law. (*Id.*)

If the Commission disagrees with the PO's conclusion that the issue is not moot as the Companies argue in their BOE (NS-PGL BOE, p. 72), then Staff recommends the following revisions to the PO with the Commission still rejecting the Companies' conditional SFV rate design tariff but for the reasons set forth above.

Proposed Modification
(PO, p. 248)

* * *

Commission Analysis and Conclusions

The Utilities propose a conditional SFV tariff for S.C. No. 1 Small Residential HTG, NH, and S.C. No. 2 General Service classes which would be implemented in the event that Rider VBA is no longer in effect because (1) a Court finds or holds that the Commission lacks or lacked authority to approve Rider VBA, or (2) Rider VBA is otherwise not permitted to remain in effect by action of the Commission. The Commission finds that the Utilities' proposal is <u>rejected. The Commission finds that as a matter of law, the proposed conditional SFV tariffs for S.C. No. 1 Small Residential HTG, NH, and S.C. No. 2 General Service classes are contrary to Section 9-201(a) of the PUA. The conditional SFV tariff fails to comply with the requirement of Section 9-201(a) that an effective date be provided in the tariff. In addition, even if the Appellate Court's March 29, 2013 opinion affirming the Commission's adoption of Rider VBA on a permanent basis is reversed on appeal, the tariffs should be rejected for many of the policy reasons set forth by the Staff. First, as Staff points out the Companies are not entitled to a guarantee of 100% fixed cost recovery. Under long established federal and Illinois constitutional law, and Illinois ratemaking law, a utility's rates must be set so as to allow it the opportunity to obtain full **recovery** of its prudent and reasonable costs of service, including its costs of capital. Second, Rider VBA and the proposed SFV tariffs are not equivalent substitutes for each other. Rider VBA recovers any under or over recovery of fixed costs on a per therm basis. The SFV rates would recover fixed costs on a per customer basis which would affect small use customers greater than the larger use customers. Third, the Companies are free to file a rate case when they deem it necessary and in fact are currently required to file biennial rate proceedings in 2014 and 2016 under Section 9-220(h-1) of the Act. Therefore, in the event the Companies believe that a different rate structure is more appropriate they have the means to address that concern. Fourth, to the extent that the Companies are concerned about adequate cost recovery, their own witnesses' testimony shows that the Companies' forecast models have performed well historically in achieving cost recovery for the Companies. Fifth, having two rates in place will cause customer confusion for ratepayers. Sixth the Commission is reluctant to approve 100% fixed cost recovery through a fixed charge. Leaving a portion of costs recovered through a volumetric charge should encourage the Companies</u>

to seek ways to improve efficiency and otherwise cut costs. Also, to the extent that the Companies experience customer growth, if all fixed costs are recovered through a monthly charge the Companies may arguably over-recover their fixed costs through the monthly charge. ~~now moot in light of the Illinois Appellate Court's recent decision issued on March 29, 2013 affirming the Commission's adoption of Rider VBA on a permanent basis in the Utilities' 2011 rate cases. Hence, the Court's recent decision addresses the Utilities' concern about the possible reversal of Rider VBA. Additionally, as stated elsewhere in this Order, the Commission continues to believe that Rider VBA is a sound rate design policy that should remain in place permanently as approved by the Commission in the 2011 rate cases and recently affirmed by the Illinois Appellate Court.~~

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D. Fixed Cost Recovery and Rider VBA

X. Transportation Issues

A. Uncontested Issues

1. Purchase of Receivables (Withdrawn)

2. Commission Authority to Order Investigation on Provider of Last Resort

B. Contested Issues

1. Cost Allocation Between Sales Customers and Small Volume Transportation Customers

With respect to the following transportation issues: (X.B.1) Cost Allocation between Sales Customers and Small Volume Transportation Customers, (X.B.2) Recovery of Supply-related Costs from Small Volume Transportation Program (Choices for You or "CFY") Customers, and (X.B.3) Recovery of Small Volume Transportation Program (Choices For You or CFY) Administrative Costs, Staff's position is as set forth below.

Response to Peoples Gas-North Shore

Staff disagrees with the Companies' BOE regarding X.B.3. Staff continues to believe that the Commission should allocate costs based on cost causation. (Staff Ex. 18.0, p. 8) Staff agrees with the ALJPO on issues X.B.1. and X.B.2., since Staff pointed out that there is not enough information to order a different allocation. And Staff also noted that the ALJs' decisions for X.B.1.and X.B.3. are not compatible, (Staff BOE, p. 58.) However, Staff does not agree that costs that are known to be caused by transportation customers should be allocated among all customers, since the information is known and the cost-causers are known. (*Id*., pp. 59-61) Finally, if the Commission wants to more accurately allocate costs between transportation and sales customers[13], Staff recommends that the Commission order the Companies to develop the needed accounting capabilities and information systems required to disaggregate costs to the Commission's specifications. (Tr., February 5, 2013, pp. 291-292)

Response to IGS

As noted above, if the Commission amends the ALJPO to allocate CFY administrative costs only to transportation customers, then Staff does not oppose the Commission requiring the Companies to develop their accounting systems in a way to more accurately apportion costs between transportation customers and sales customers. If the Commission does not alter the PO with respect to Sections X.B.1., X.B.2., and X.B.3., it is, in effect, ordering the Companies to allocate all costs to both sales and transportation customers.

[13] Sales customers are customers who obtain their gas supply from North Shore/Peoples Gas. Often times referred to as PGA customers.

On the other hand, IGS has written exceptions to the Commission Decision in Sections X.B.1. and X.B.2 of the ALJPO, that argue that the Commission should require a disaggregation of these costs between sales and transportation customers, apparently regardless of whether or not the Commission upholds the recommendation to socialize the CFY administrative costs in Section X.B.3.[14] (IGS BOE, Attachment A, Proposed Replacement Language, pp. 3-6) If that is IGS's intent, IGS would have the Commission invert the alleged result from the current cost allocation regime. Prior to this rate case, IGS worries that transportation customers paid for costs not attributable to them, while paying all CFY administrative costs. In its BOE, IGS is recommending that the Commission disaggregate costs so transportation customers pay no costs that are not attributable to them. (IGS BOE, pp. 9-14) At the same time, IGS recommends sales customers share CFY administrative costs, which are wholly attributable to transportation customers. (*Id*., pp. 14-15) This is no more logical than the current situation that IGS argues against. In particular, there is no need, if all costs are socialized, to identify which non-CFY costs are caused by which group. In particular, IGS recommends that the Commission issue an order stating in part:

> However, this conclusion ought not [sic] be interpreted in future cases as foreclosing a more detailed inquiry into the accounting for and allocation of supply-related costs. On the contrary, we view the remedy here as an interim step; in future rate cases and other proceedings involving cost allocation, the Companies should be prepared to explain in a credible, testable manner how it accounts for and allocates all of its supply-related costs.

[14] As Staff pointed out in its BOE, IGS exaggerates the effect that the CFY administrative cost charges have on participation in the CFY program. The charges have already dropped to less than half their value from 2010, while IGS continues to decry the state of the SVT market in the Companies' territories. (Staff BOE, pp. 93-34)

(IGS BOE, Attachment A, Proposed Replacement Language, p. 6)

Staff does not recommend that the CFY administrative costs be socialized between sales and transportation customers. But if the Commission disagrees, it should not err in the opposite direction and socialize all of the CFY administrative costs while disaggregating transportation customers' costs. That creates a cost misallocation that disfavors sales customers.

2. Recovery of Supply-related Costs from Small Volume Transportation Program (Choices for You^{SM} or "CFY") Customers

See X.,B.,1.

3. Recovery of Small Volume Transportation Program (Choices for You^{SM} or "CFY") Administrative Costs

See X.,B.,1.

4. Provider of Last Resort Investigation

XI. CONCLUSION

Staff respectfully requests that the Illinois Commerce Commission approve Staff's recommendations in this consolidated docket.

Respectfully submitted,

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